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# INTRODUCTION

Insurance is a product with a distinction from most others given its essential nature to the citizens of Michigan and the fact that, in some cases, it is required by law.

Unfortunately, increasing insurance costs are threatening the economic security of Michigan citizens. High costs are absorbing too large a portion of a consumer's income as rates rise and wages remain stagnant. In some cases, individuals and families are being forced to move out of urban centers that typically experience the highest insurance rates.

As the state is faced with the challenges of revitalizing and growing strong communities, greater attention must be placed on making communities affordable places for people to live. This includes providing people with access to reasonably priced insurance products.

To that end, the Senate Democratic Caucus formed a Consumer Protection Task Force earlier this year to determine future policy recommendations that will create an equitable and just environment for Michigan automobile and homeowner insurance policy holders.

In addition to soliciting feedback online, the Consumer Protection Task Force held hearings in Detroit, Muskegon, and Saginaw to gather public input on consumer protection issues that affect individuals and families.

The valuable testimony and data contained in this report combined with a new administration committed to moving all of Michigan forward provides leaders in the Senate Democratic Caucus with a renewed sense of optimism that legislation calling for consumer-focused insurance reforms will receive serious consideration.

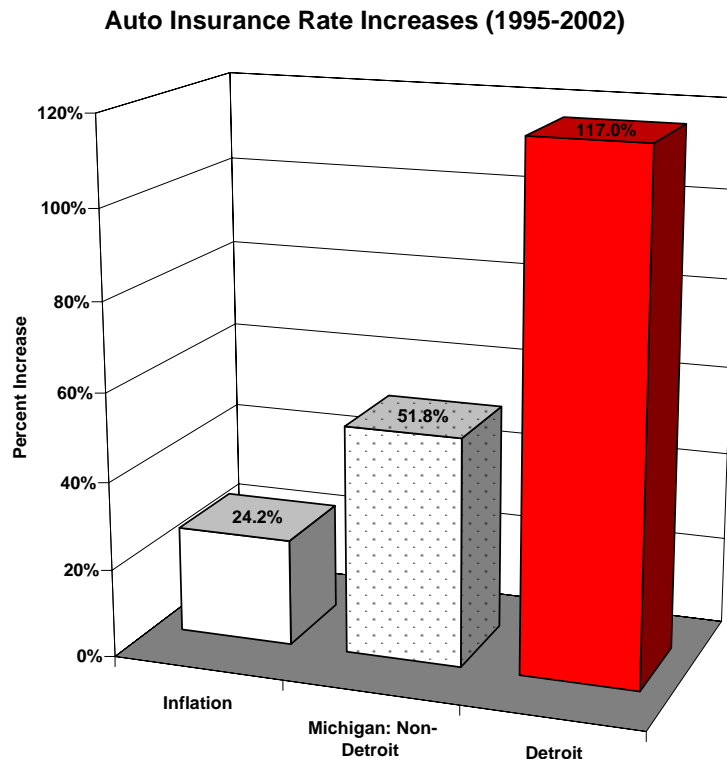
# BACKGROUND INFORMATION

## Automobile Insurance

Past insurance reform movements in Michigan were built primarily on the argument that increased competition would encourage affordable insurance rates across the state.

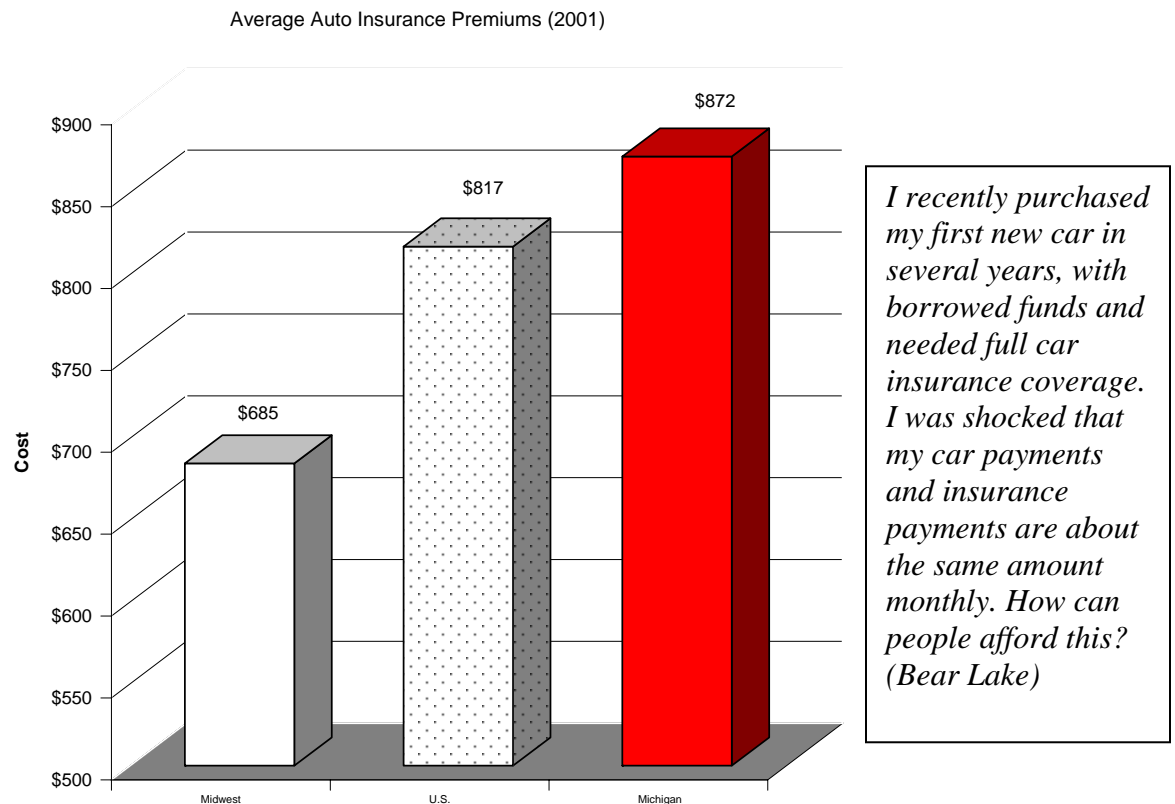
Reports released from the State of Michigan Office of Financial and Insurance Services show that now, more than ever before, Michigan has greater insurance competition. However insurance rates have continued to increase far beyond the rate of inflation across the state, and skyrocketed in large urban centers like Detroit.

*I recently moved back to Detroit from Okemos. My insurance went from \$749 every six months to \$1,889 every six months. So my insurance has gone from \$1498 a year to \$3778 a year, a difference of \$2280, for the same service. As I shopped around looking for more competitive rates, all I found were more of the same criminal, abusive, oppressive insurance practices plagued upon Detroit residents.  
(Detroit)*



As seen in the chart above, auto insurance rate increases in Michigan have outpaced inflation by more than a 2-to-1 ratio. In Detroit, insurance rates have outpaced inflation by more than 4-to-1 during the past eight years.

Not only are there vast disparities among auto insurance rates within the state, Michigan also has some of the highest auto insurance rates in the country according to a recent study by the National Association of Insurance Commissioners. Michigan auto insurance rates are much higher than the average among Midwestern states. And Michigan's average premium for automobile insurance is even higher than the national average.



The fact remains that greater competition **has not kept** insurance premiums at a reasonable level. Past insurance reforms, including the elimination of territorial rating constraints have resulted in substantially higher—not lower—insurance rates across Michigan, especially in Detroit.

These high rates have negative social, in addition to economic, implications for Detroit. As reported by the Detroit News earlier this year, there are as many as 1.1 million uninsured motorists on Michigan roads. In the city of Detroit, 46 percent of vehicles are reported to be uninsured. The correlation between Detroit having both the highest insurance rates and highest number of uninsured motorists in the state is not a coincidence.

In order for the no-fault law to function effectively in Michigan, insurance rates must be affordable. As long as auto insurance rates continue to be excessive, more and more drivers will choose not to obtain coverage.

Unless major insurance reforms are enacted soon, Michigan will continue to have the twin problems of spiraling auto insurance costs and a rising number of uninsured drivers.

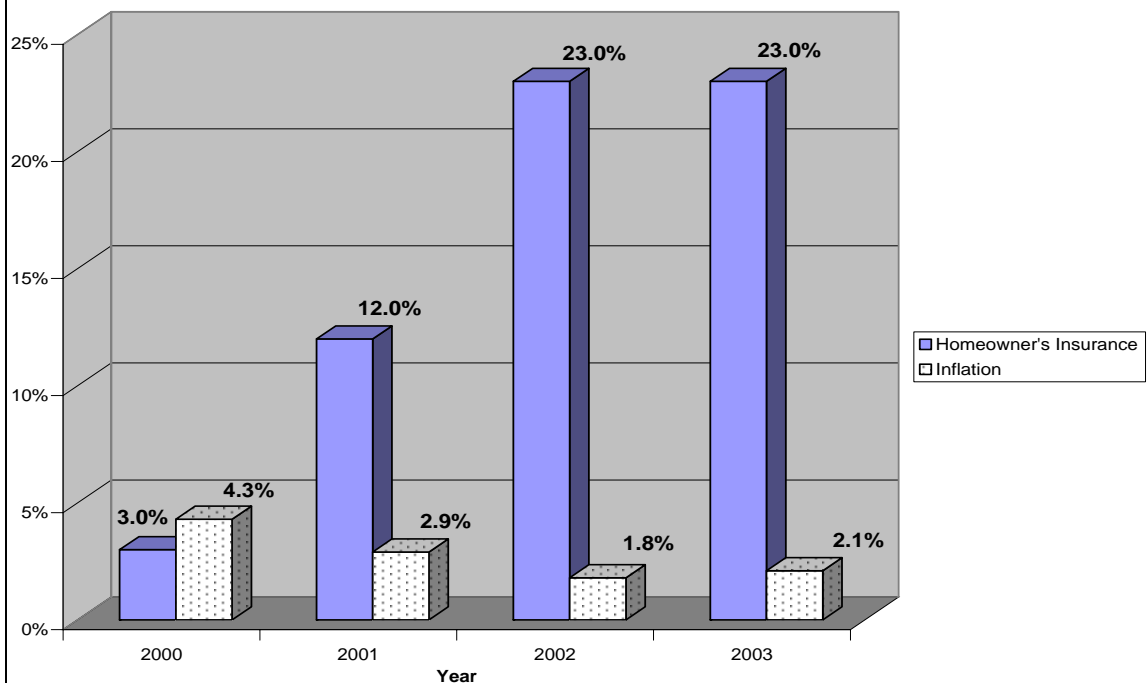
## Homeowners Insurance

Homeowners across the state have seen double-digit increases in their insurance premiums during the last couple of years. This year alone, many will see another 23 percent increase in their rates, according to a recent report Muskegon Chronicle. Just last year, homeowner insurance policy holders in Michigan saw rates nearly double those in other states. trend has continued in 2003.

*My husband and I have always had to be very careful with our finances. I am a stay at home mom so money must stretch farther. We have never had an insurance claim since we were married 8 years ago. This month, we were notified from our insurance company that our homeowner's insurance has jumped 72 percent. They say their costs have gone up, so ours have too. Just as we were beginning to get ahead, wham, stuck with paying more and more. To increase their rate 72 percent!!*

*It is time people like us were heard and listened to.  
(Battle Creek)*

Homeowners' Insurance Rate Increases (2000-2003)



Homeowners feel that they are being charged higher rates to compensate for the money insurance companies lost due to poor performing investments.

In the Muskegon Chronicle article, Rick Gamber, executive director of the Michigan Consumer Federation, said, “The insurance companies have a cash cow, namely the consumer, who can cover up their poor investment strategy.” He also said, “So long as they can get profits from rates, they’re going to continue to pump them up.”

In support of the preceding claims, during the past four years, the nation's economy drastically cooled off in comparison to the second half of the 1990s. This slow down directly correlates to rapid increases in homeowner's insurance rates, but not actual insurance claims.

## Credit Scoring

The use of credit scores by insurance companies to determine auto and homeowners insurance premiums is a growing practice in the state of Michigan and across the nation. It is a practice many insurance companies employ by using an individual's credit rating as a factor in determining insurance rates. However, the arbitrary nature of credit scoring has contributed to the belief by many consumers that it is merely another form of illegal redlining.

Insurance companies are authorized to rely on the use of credit scores under Section 2110a of the Insurance Code, MCL 500.2110a for the purpose of determining premium discounts for automobile and homeowners insurance. Insurers may also use credit scores for applying surcharges under group policies which are not covered by the Essential Insurance Act contained in the Insurance Code.

The practice of using credit scores began in the auto insurance industry in 1997 and in the home insurance industry in 1999. To date, more than 50 percent of Michigan automobile and homeowners insurers use some form of credit history to rate policies.

Credit-based insurance scoring is often the subject of harsh controversy about whether there is a logical and independently verified connection between an individual's credit worthiness and the likelihood that he or she will file a claim. Credit scoring also raises a number of concerns about the way an individual's credit information is used, how much information is available to consumers, and the ability to correct inaccuracies.

Many insurers argue that the use of credit scores results in consumers paying less than they otherwise would. However, because insurance companies are able to inflate their base rates by establishing them on the worst possible risk while using credit scores to discount those rates; it is arguable that consumers actually receive any benefit. In this regard, credit scores are not being used as an accurate measure for identifying risk, but rather, as a marketing tool that merely aims to penalize those with impaired or no credit history.

*I'm concerned about the amount of money I pay for auto insurance. I have a perfect driving record, yet every insurance company I've called quotes me very high insurance rates. The lowest was \$2400 for 6 months. They are also taking into account my credit rating. I fell into financial hardship years ago and was unable to pay my bills, which led to a bad credit rating.*

*Why should I be penalized even more by the insurance companies when I've keep a perfect driving record and have had zero claims. My coworkers look amazed when I tell them how much I pay for auto and home insurance. They live in the suburbs. What can I do to get affordable insurance?*

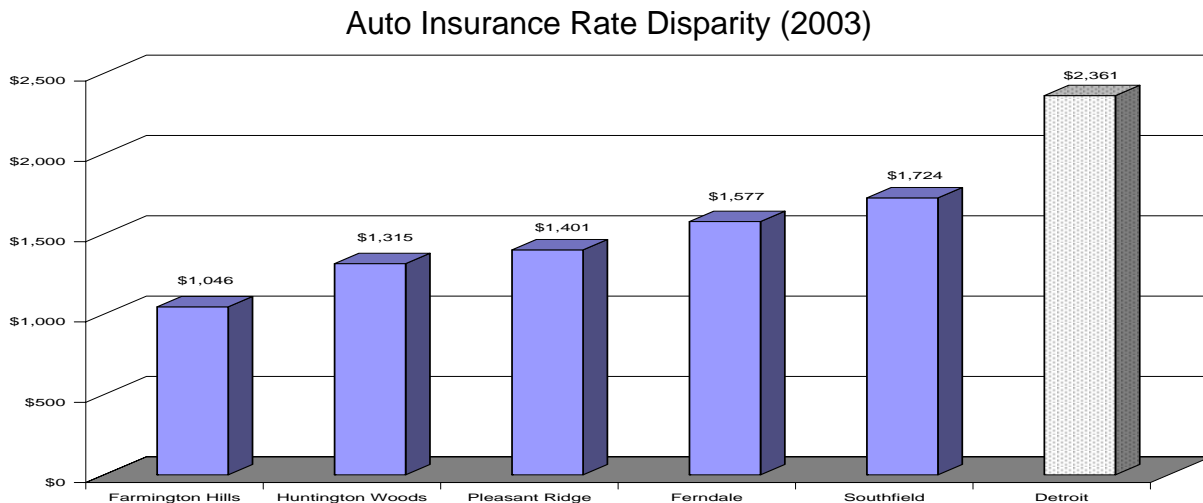
*(Detroit)*

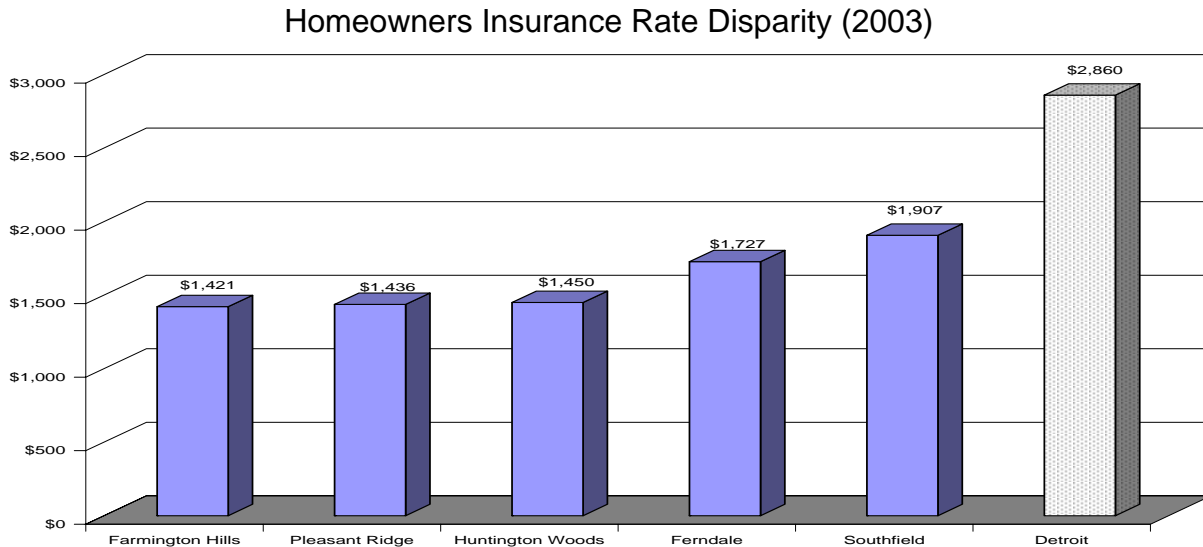


## Redlining

Redlining is most commonly associated with the discriminatory practice by insurance companies of either refusing to write insurance or providing only costly inferior insurance coverage to people who live in certain areas of the state. It has most recently been associated with the practice of tying credit scores to insurance rates.

A 1978 Michigan Supreme Court decision found that auto and homeowners insurance are essential to consumers and that the state has a duty to guarantee that insurance is available at fair and equitable rates to everyone. Yet, 25 years later, residents in the City of Detroit are paying more than twice as much for automobile insurance in comparison to other areas of the state. Such disparity is substantiated in the 2003 Buyers' Guide to Auto Insurance in Michigan prepared by the Office of Financial and Insurance Services which identifies automobile insurance companies and a sampling of their rates for different policies for different areas of the state.





The existence of wide spread disparities in auto and homeowners insurance rates for residents of urban areas, particularly Detroit, as compared to those living in rural areas suggests that redlining is a practice that remains a reality. It further demonstrates the need for greater transparency in how insurance rates are calculated.

There is also a growing concern that credit-based insurance scoring has worsened the availability and affordability of insurance. Some consumer advocates maintain that credit scoring is unfair and discriminatory and penalizes people who have lower income or a poor credit history. They argue that insurance rates should be based on objective criteria.

*I have been a citizen of Detroit for 41 years, and it is a shame that I have to move out of the city to have lower auto and homeowners insurance.*

*The insurance companies have been redlining for years and nothing has ever been done to stop this outright form of redlining. Why should I have to pay high insurance rates? (Detroit)*

## **REAL TIME SURVEY**

Thanks to technology from the Michigan Virtual University, a Real Time Public Survey was conducted during each task force hearing. The survey was designed to solicit and collect attendee feedback electronically on six pre-selected questions.

Audience members in Detroit, Muskegon, and Saginaw were asked questions one at a time and then selected their top answer from the choices available.

- Overall, attendees were most concerned with redlining (39 percent) and access to affordable insurance (35 percent).
- Nearly 8 out of 10 (78 percent) people felt that they did not have enough information about their insurance options.
- Almost two-thirds (63 percent) of respondents stated that they have had to go without home or auto insurance coverage at one time because they could not afford it.
- More than half (56 percent) were not satisfied or very unsatisfied with their insurance carrier or carriers.
- Sixty percent of respondents said they received most of their insurance information from insurance agents, while 31 percent get most of their information from friends and coworkers.

# REAL TIME SURVEY DATA

Of the following five choices, what is your top concern?

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Redlining	50%	Redlining	10%	Redlining	25%	39%
Credit Scoring	12%	Credit Scoring	50%	Credit Scoring	6%	17%
Identity Theft	4%	Identity Theft	20%	Identity Theft	0%	6%
Medical Information Privacy	4%	Medical Information Privacy	0%	Medical Information Privacy	6%	4%
Access to Affordable Insurance	30%	Access to Affordable Insurance	20%	Access to Affordable Insurance	63%	35%

Do you feel you have enough information about your insurance options?

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Yes	11%	Yes	50%	Yes	33%	21%
No	89%	No	50%	No	67%	78%

Have you ever had to go without home or auto insurance because you could not afford it?

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Yes	42%	Yes	25%	Yes	29%	37%
No	58%	No	75%	No	71%	63%

Are you satisfied with your insurance carrier or carriers

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Very Satisfied	10%	Very Satisfied	31%	Very Satisfied	7%	13%
Satisfied	17%	Satisfied	23%	Satisfied	50%	24%
Not Satisfied	21%	Not Satisfied	31%	Not Satisfied	36%	25%
Very Unsatisfied	44%	Very Unsatisfied	8%	Very Unsatisfied	7%	31%
Not Sure	8%	Not Sure	8%	Not Sure	0%	6%

Where do you get most of your insurance information from?

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Family	3%	Family	0%	Family	6%	3%
Insurance Agents	61%	Insurance Agents	79%	Insurance Agents	41%	60%
TV and Newspapers	3%	TV and Newspapers	14%	TV and Newspapers	0%	4%
The Computer	1%	The Computer	0%	The Computer	0%	1%
Friends and Coworkers	31%	Friends and Coworkers	7%	Friends and Coworkers	53%	31%

Would you purchase long-term care insurance if it were available?

<u>Detroit</u>		<u>Muskegon</u>		<u>Saginaw</u>		<u>Overall</u>
Yes	78%	Yes	85%	Yes	75%	78%
No	22%	No	15%	No	25%	21%

## **SUMMARY OF TESTIMONY**

Throughout the task force hearings on insurance industry reform, informative testimony regarding the current insurance system and skyrocketing insurance rates was provided by concerned citizens, insurance industry representatives, attorneys, advocacy groups and elected officials both in-person and online.

The issues that engaged the greatest discussion during the hearings were significant rate increases in homeowners and auto owners insurance, redlining, the use of credit scores for determining insurance rates, and the failure of certain insurance companies to promptly settle claims.

## Insurance Rates

Many area citizens provided the task force with personal accounts of homeowners and auto insurance rate increases that more than doubled in the last year. In most cases, these individuals have never filed a claim. In one example, a Detroit homeowner testified that her insurance increased from \$800 to \$2102. In another instance, a homeowner from Detroit indicated his insurance increased from \$390 to \$877 in one year on a home that is less than 800 square feet.

In another example, a Detroit resident indicated that his home insurance increased from \$1,000 in 2002 to \$3,943 in 2003. This trend carried over to other areas of the state where a Battle Creek resident indicated that her homeowners insurance recently increased 72 percent.

Several consumers questioned how their residential address correlates to their driving record. One individual indicated that she has been driving for 21 years without an accident and does not believe that it is fair that insurance companies are able to bill for insurance for reasons other than her driving record. She also expressed serious concerns about having to pay as much for auto insurance as individuals with a bad driving record living outside of the City of Detroit.

In some instances, consumers have used a different address in order to obtain a lower premium. This was the case for one Detroit resident who claimed he was successful in saving \$1540 for an auto insurance policy by using an address outside of the city.

While the revelation of exorbitant insurance rate increases is problematic by itself, consumers expressed concern about the lack of sufficient notification of rate increases provided by insurance companies. In one example, a Detroit homeowner accepted an insurance policy at a rate of \$1,300 that later increased to \$3,500 without any notification from the insurer.

Larry Norman of L.W. Norman & Associates suggested that the way to lower insurance rates is to look at the no-fault law and recognize that it is flawed. He indicated that unlimited medical benefits provided under the law drive up auto insurance rates. He further suggested examining the cost savings associated with eliminating the no-fault system and returning to a tort-based insurance system where at fault drivers are responsible for paying the victim's medical expenses and compensating for additional damages, such as loss of wages and "pain and suffering."

Alternatively, Ward Verseput, a State Farm insurance agent, expressed strong concerns about returning to insurance systems of the past that would lead to even higher insurance rates. He maintained that insurance rates should be based on experience and emphasized the significant difference in risk associated with driving 40 mph on a two lane road in a rural area in comparison to driving 70 mph on a four lane road in urban areas.

Don Carpenter, an independent insurance agent in Muskegon, explained to members of the task force that the difficulty in the insurance market is a result of the weak economy. He stated that when insurance companies made money on investments, they could be looser in their underwriting. This essentially allowed insurers to keep premiums at a minimum.

Mr. Carpenter also identified the problem of individuals who use an insurance policy as a maintenance policy that drives up the cost of insurance for those who do not make claims.

## Redlining

The continuation of insurance rate increases has led many residents, particularly in the City of Detroit, to consider relocating to other areas of the state where it has been proven that insurance rates are dramatically lower. To many, the higher cost of insurance in Detroit is simply another tax.

In one example, a thirty year resident of the City of Detroit indicated that she was making plans to leave the city because of the outrageous prices mandated in order to have insurance on her vehicle and property. Another resident who has lived in Detroit for 41 years suggested having to leave the city in order to obtain lower auto and homeowners insurance. In another case, a women indicated that her daughter moved from Detroit to Ann Arbor and her other daughter would also be leaving Detroit because she can not afford to live there due to the expensive insurance costs.

It is also impossible for some people to maintain employment because the cost of maintaining insurance coverage on their vehicle is more than they can afford. Several consumers provided examples of their monthly auto insurance premiums equaling or exceeding their monthly car note. This is especially difficult for consumers who must show proof of insurance in order to purchase a vehicle.

A resident from Frankfort indicated that her and her husband's social security has gone to pay the premiums of their auto and homeowners insurance. The father of a Detroit area resident has experienced a similar dilemma. He has been paying \$2000 per year in automobile insurance on a fixed income

Many residents of Detroit ultimately feel they are being held hostage because insurance is a requirement for driving a vehicle in the State of Michigan and for all homeowners borrowing money to pay for their home. Without insurance coverage, a person' runs the risk of having their vehicle's registration canceled by the Secretary of State or in the case of homeowners insurance, his or her mortgage could be canceled by the lender.



## Credit Scoring

The real time data received from participants at the hearings suggests that credit scores are among the greatest concern to consumers. This was also evident in the testimony provided by members of the general public.

Economic redlining was most often associated with the practice of insurers using credit scores for determining insurance rates. One Detroit resident stated that credit rating compounds redlining and is an example of insurance companies exploiting consumers.

Consumers at each hearing challenged whether there is any correlation between an individual's financial behavior and the likelihood that he or she will submit an insurance claim. The problem is further exacerbated by the lack of information insurance companies provide to policyholders regarding their credit score. One resident from Farmington Hills who claimed to have excellent credit indicated that he was provided no information relating to a credit score of 762 that he received from an insurance company. His concern is that credit reports are frequently inaccurate and result in negative scores.

Another concern associated with the use of credit scores is that it unfairly penalizes individuals for life factors that can negatively impact an individual's credit history. This was the case for a Saginaw area resident who co-signed a loan that defaulted and resulted in him receiving a negative credit rating. In another instance, a Detroit resident fell into financial hardship several years ago and was unable to pay his bill, which lead to a bad credit rating. As a result, the lowest auto insurance policy he was able to find was \$2,400 for six months.

Birny Birnbaum from the Center for Economic Justice provided additional testimony regarding the use of credit scores. His comments included the following:

- Credit Scoring is the new high tech method of redlining
- Many insurance rate increases are a result of insurance companies introducing credit scores.
- The essence of insurance is spreading the risk, but when it comes to insurance companies, the essence is charging as much as possible.
- A good credit history doesn't equal a good credit score.
- Credit score models are structurally biased.

## Claims Handling

Several comments were received about the current claims handling environment for policyholders. In particular, disputes over the scope of insurance coverage that often leaves the policyholder at a tremendous disadvantage because there is no economic penalty for insurance companies to deny claims and there are few exceptions for getting attorney fees reimbursed.

While insurance is sold as a peace of mind, several consumers suggested that insurance companies look for any reason to deny claims. One individual testified to her personal experience with an insurance company as a result of a fire that destroyed all of her personal property. She indicated that although she had never been late on an insurance payment, she was treated like a criminal and forced to suffer unnecessary stress in her efforts to recover damages from the insurer.

Robert June, a private practice attorney, presented his views of a structural problem within the Office of Financial and Insurance Services (OFIS) that has traditionally treated the insurance industry as the customer. His comments echoed others that indicate the need for a level playing field between insurance companies and policyholders.

Mr. June's recommendations include establishing a punitive damages statute to prevent insurance companies from dealing in bad faith, placing limitations on coordinating auto insurance and health insurance policies, and requiring insurance companies to inform consumers of the consequence of coordinating insurance policies.

A Muskegon area resident indicated in his testimony that the concept of no-fault insurance is to be paid within 30 days, and that is often violated by insurance companies. He suggested the need to ensure that citizens get reimbursed for their claims. In addition, insurance companies should not be allowed to use their own claims specialists for handling claims that can be predicted to favor the insurer.

## **TASK FORCE RECOMMENDATIONS**

After careful review of the testimony provided during the Consumer Protection Task Force on Insurance Industry Reform, it is evident that the insurance market in Michigan continues to be unfavorable as rates have soared and disparity clearly exists. Many consumers are looking for answers to questionable rates and practices promulgated by the insurance industry and demand reform that will provide meaningful relief.

The Senate Democratic Caucus is committed to working to resolve the problems associated with the current insurance system that has led to unaffordable rates. In an effort to address the concerns identified throughout the task force hearings, the task force recommends the following:

- Provide better protection for policyholders by implementing a rate review system that requires insurance companies to file actual rates on an annual basis with the Office of Financial and Insurance Services and require approval of those rates by the Insurance Commissioner before they take effect.
- Require insurance companies to provide policyholders with a minimum 60 day written notice of any automobile and homeowners' insurance rate increases in order to provide policyholders with an opportunity to seek a lower rate.
- Prohibit insurance companies from using an individual's credit history or credit score for determining automobile and homeowners' insurance rates.
- Establish a flexible rating program under the Insurance Code designed to help stabilize insurance rates where rates are determined through the application of flexibility bands to a benchmark rate.
- Increase inadequate civil and criminal penalties for violations under the Insurance Code including violations of unfair trade practices under Chapter 20.

- Require the Michigan Catastrophic Claims Association (MCCA) to be subject to greater scrutiny. This should be accomplished by requiring the MCCA to comply with the Freedom of Information Act and the Open Meeting Act. In addition, requiring the MCCA to be subject to an annual audit of accounting practices by the Auditor General.
- Prohibit insurance companies from requiring policyholders to use a particular automotive repair facilities and inexpensive non-factory replacement parts in the repair of their automobile.
- Require insurance companies to provide a written notice of the causes that would lead to cancellation or ineligibility for insurance coverage.
- Require insurance companies to deal fairly with policyholders who file a claim by providing them with a cause of action against an insurance company that fails to negotiate and settle an insurance claim in good faith.
- Require insurance companies to accurately disclose to policyholders and applicants for insurance coverage the meaning of coordinating medical insurance coverage through a no-fault insurance policy.
- Establish rate standards under the Insurance Code that prohibit automobile and homeowners insurance rates from being excessive and unfairly discriminatory.
- Prohibit insurance companies from refusing to insure, limiting coverage, or charging different rates based on a particular geographic location.
- Require insurers who issue automobile or homeowners insurance to file certain information with the Insurance Commissioner regarding the average time insurers take for processing a claim and make that information available for public review.
- Enhance discrimination provisions under the Insurance Code to more effectively prohibit insurance rate discrimination based on race, color, creed, or national origin.
- Encourage OFIS to continue its efforts to generate greater awareness of insurance options among Michigan consumers.

## **ACKNOWLEDGMENTS**

The Senate Democratic Caucus Consumer Protection Task Force on Insurance Industry Reform would like to thank the many concerned citizens who testified at these hearings or submitted their comments on the task force Web site. Their input was very important to us and contributed to the development of the proposed recommendations provided in this report. However, out of respect for their privacy, we have not identified the names of private citizens.

The Senate Democratic Caucus appreciates the hospitality of the following organizations for hosting task force hearings:

St. John NorthEast Community Hospital

Muskegon Community College

Saginaw County Courthouse